DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT

Office of the Assistant Secretary for Housing—Federal Housing Commissioner

24 CFR Part 3500

[Docket No. FR 3780–P–01]

RIN 2502–AG40

Real Estate Settlement Procedures Act (RESPA): Disclosure of Fees Paid to Mortgage Brokers (Retail Lenders), and Notice of Consideration of Negotiated Rulemaking

AGENCY: Office of the Assistant Secretary for Housing—Federal Housing Commissioner, HUD.

ACTION: Proposed rule and notice of consideration of negotiated rulemaking process.

SUMMARY: The Department has developed a proposed rule presenting alternative approaches to the disclosure of fees to retail lenders and other matters relating to such fees that are addressed in HUD's current regulations implementing the Real Estate Settlement Procedures Act (RESPA). Under this proposed rule, the Department specifically seeks comments on whether the disclosure of indirect fees paid to mortgage brokers is useful to the consumer and should continue to be required. Disclosure of direct charges imposed upon the borrower or seller is clearly required under Section 4 of RESPA and is not the subject of this proposed rule.

The Department also has commenced the convening process to determine whether to establish a committee for negotiated rulemaking on this proposed rule. If negotiated rulemaking appears desirable and feasible, then the Department expects to undertake the establishment of such a committee by publication of a separate notice in the **Federal Register**. If a negotiated rulemaking committee is formed, the public comments concerning the substance of this proposed rule will be given to the committee for consideration in its deliberations. If it is determined that a committee is not appropriate, the comments submitted on this proposed rule will be used by the Department in promulgating a final rule.

DATES: Comment due date: November 13, 1995.

ADDRESSES: Interested persons are invited to submit comments regarding this proposed rule, the feasibility of forming a negotiated rulemaking committee, and suggestions for committee participation to the Rules Docket Clerk, Office of General Counsel, Room 10276, Department of Housing and Urban Development, 451 Seventh Street, SW., Washington, DC 20410–0500. Communications should refer to the above docket number and title. Facsimile (FAX) comments are *not* acceptable. A copy of each communication submitted will be available for public inspection and copying between 7:30 a.m. and 5:30 p.m. weekdays at the above address.

FOR FURTHER INFORMATION CONTACT: David R. Williamson, Director, RESPA Enforcement, Room 5241, Department of Housing and Urban Development, Washington, DC 20410; telephone 202–708–4560; or (for legal questions) Grant E. Mitchell, Senior Attorney for RESPA, Room 10252, Department of Housing and Urban Development, Washington, DC 20410; telephone 202–708–1552 (these are not toll free numbers). Hearing or speech-impaired individuals may call 1–800–877–8339 (Federal Information Relay Service TDD, which is a toll-free number).

SUPPLEMENTARY INFORMATION: The current RESPA regulations make clear that ''secondary market transactions'' are not covered by most provisions of RESPA: ''a bona fide transfer of a loan obligation in the secondary market is not covered by RESPA and this part, except as set forth in section 6 of RESPA and § 3500.21 [mortgage servicing transfers].'' The current rule details certain tests for what does or does not constitute a secondary market transaction. The Department seeks comments on its classifications of mortgage loan transactions under the current rule as ''primary funding'' or ''secondary market'' transactions and, in particular, on whether the Department has drawn the line in the appropriate place between a primary funding and a secondary market transaction.

The Department also seeks comments on aspects of its current regulations that provide, *inter alia,* that all fees paid to mortgage brokers, either directly or indirectly, must be disclosed on the Good Faith Estimate and the HUD–1 or HUD–1A, which are furnished to borrowers/consumers. Specifically, the Department seeks comments on its determination that the disclosure requirement for ''all charges imposed on the borrower'' includes fees paid to the mortgage broker by the lender, because all charges are ultimately borne by the borrower. Finally, the Department, in this proposed rule, also requests comments regarding a related issue: whether certain compensation by lenders to mortgage brokers normally paid after settlement, based on the volume of loans produced, should be permitted and disclosed under RESPA.

I. Certain Definitions in Proposed Rule

In this proposed rule, mortgage brokers [1] and certain other mortgage originators are frequently referred to as ''retail lenders.'' Entities that purchase mortgage loans are frequently referred to as ''wholesale lenders.'' In any event, the description of the lender is not dispositive of whether the transaction is covered by the rule. The proposed rule would apply to a transaction based on the characteristics of that transaction, rather than on whether the lender generally functions in a retail or a wholesale capacity.

II. RESPA Coverage

A. Background

The Real Estate Settlement Procedures Act of 1974 (12 U.S.C. 2601 *et seq.*) (RESPA) was enacted for several purposes, ''including insuring that a consumer engaged in a real estate settlement is afforded effective information about the transaction in a timely manner.'' In addition, the Congress sought to address specific abusive settlement practices that had developed in certain areas of the country. In this proposed rule, HUD is seeking public input on specific disclosure-related issues, including where the lines should be drawn to determine whether RESPA applies.

Since 1974 the mortgage lending industry has experienced a rapid evolution. This industry has experienced major technological advances—new and different kinds of business entities have entered the field, and new business relationships have emerged among the various entities that serve the consumer in a single lending transaction. Much of the change that has occurred is attributable to the growth of the secondary market during the 1980s.

Prior to the 1980's, a mortgage loan transaction was relatively easy to understand. A lender (*e.g.*, a savings and loan, mortgage bank, or commercial bank) typically processed a loan from

[1] The historical discussion in this proposed rule uses the term ''mortgage broker'' because this is the terminology that the Department used in addressing the issue in both the informal opinion and regulatory context. Section 3500.4(d) of the current RESPA rule withdrew all previous informal legal opinions, in particular a letter of August 14, 1992, issued by a former General Counsel of HUD, which dealt extensively with the disclosure of mortgage broker fees and the manner in which such fees should be disclosed on the HUD–1. This preamble uses the term ''retail lender'' whenver feasible in discussing the proposed rule and when the discussion does not clearly require the use of the term ''mortgage broker.''

start to finish. The loan application was processed, evaluated, and underwritten by the lender's own employees. The loan was funded by and closed in the lender's name. The loan was usually held in the lender's portfolio of loans, and any activities regarding the loan (receiving and crediting the payments, paying out monies from an escrow account, etc.—sometimes called ''servicing'') were handled by that lender. Sometimes the loan was sold to another entity, in a ''secondary market'' transaction that was a precursor of today's more sophisticated secondary market transactions.

By the end of the 1970s and into the early 1980s, two Government-sponsored enterprises (Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Corporation (Freddie Mac)) had developed into major purchasers of mortgages from original lenders. By the early 1980s, these secondary market entities not only bought mortgage loans, but repackaged many of these loans and sold them as mortgage-backed securities and, with the liquidity created, were able to be even greater purchasers of lenders' mortgage loans. By 1994, Fannie Mae and Freddie Mac were purchasing or otherwise dealing in more than 70 percent of all the conventional 1- to 4-family residential mortgage loans originated in the United States.

Today, the retail lender that works with the consumer to process and close a mortgage loan often is not the entity that will hold or service the loan. Rather, the retail lender serves as an intermediary between the consumer and the entity purchasing or servicing the loan (or ''wholesale lender''). Many loans are purchased by, or servicing is transferred to, a wholesale lender at, or shortly after, closing. When a retail lender serves as an intermediary, it may perform services for which it is compensated in processing the loan. Compensation paid to a retail lender therefore may be ''direct'' and ''indirect.'' Direct payments are fees paid directly by the consumer and must be disclosed under Section 4 of RESPA; indirect payments are fees paid by the wholesale lender to the retail lender. The issue arises over whether the amount and nature of indirect compensation should be disclosed to the consumer. HUD has been presented with arguments that the current RESPA rule, which requires disclosure of all indirect payments to mortgage brokers, focuses too narrowly on this particular class of retail lenders or intermediaries. These arguments suggest that the underlying issues for discussion should be how RESPA's fee disclosure requirements should apply to compensation of mortgage brokers, mortgage bankers, and other financial institutions that originate mortgages (retail lenders) by entities that purchase their mortgages (wholesale lenders).

B. Legal Analysis Under the Current Regulation

Section 4(a) of RESPA (12 U.S.C. 2603(a)) requires the Secretary to create a uniform settlement statement that ''shall conspicuously and clearly itemize all charges imposed on the borrower * * * and the seller in connection with the settlement.'' The stated purposes of the statute include the provision of ''greater and more timely information as to the nature and costs of the settlement process'' by ''more effective advance disclosure to homebuyers and sellers of settlement costs * * *'' (12 U.S.C. 2601). Section 5(c) (12 U.S.C. 2604(c)) of RESPA requires the provision of a ''good faith estimate of the amount or range of charges for specific settlement services the borrower is likely to incur in connection with the settlement. * * *''

Under HUD's current rules, the disclosure of all fees paid to retail lenders, including all compensation from wholesale lenders, is required when the retail lender is being compensated as part of the settlement transaction. This position is set out, *inter alia*, at 24 CFR 3500.5(b)(7); in the Instructions for filling out the HUD–1 and HUD–1A in Appendix A; and in Illustrations of Requirements of RESPA, Fact Situations 5 and 12 in Appendix B. This same disclosure requirement has not been applied to subsequent purchases of loans by wholesale lenders, on the theory that Congress only intended to cover costs related to the initial settlement transactions. The Department's current regulations, therefore, treat compensation to the retail lender under three settlement situations somewhat differently, depending upon how the loans are funded at settlement.

(1) Loan Closing and Subsequent Assignment of the Loan. This is a transaction in which a retail lender processes the loan from start to finish, funds the loan, and closes the loan in its own name. The current RESPA regulation requires that such retail lenders disclose the fees paid by the consumer. At a later point in time, the retail lender may sell the loan to a wholesale lender. The Department has not required that the terms of this subsequent secondary market transaction, including compensation paid to the retail lender by a wholesale lender, be disclosed to the consumer.

(2) Loan Closing in the Wholesale Lender's Name Using the Wholesale Lender's Funds. For this arrangement, the retail lender originates the loan, but is functioning solely in the capacity of an intermediary. The loan funds are provided by the wholesale lender and the loan is closed in the wholesale lender's name. The wholesale lender typically sets the underwriting criteria and makes the underwriting decision. In this instance, the current RESPA regulation applies to the entire fee arrangement between the retail lender and the wholesale lender. The Department regards the retail lender as being compensated as part of the settlement transaction. Indirect, as well as direct, payments to the retail lender must be disclosed under the current RESPA regulations.

(3) Table-funding. For this arrangement, the loan is processed by the retail lender and is closed in the name of the retail lender. There is, however, at or about the time of settlement, a simultaneous advance of loan funds to the retail lender by the wholesale lender and an assignment of the loan and servicing rights to the wholesale lender. Table-funding is therefore somewhat a hybrid of the two arrangements described above. As in situation (1), where the Department requires disclosure of the compensation at settlement, the loan is closed in the name of the retail lender. There is a subsequent assignment of the loan to the wholesaler. Thus, an argument could be made that the assignment constitutes a secondary market transaction, for which the terms (*i.e.*, concerning the retail lender's indirect compensation) are not required to be disclosed under the RESPA regulations. On the other hand, because the mortgage broker assigns the loan simultaneously with closing, it may be asserted that the mortgage broker acts only as an intermediary, as in situation (2).

HUD has consistently determined, in opinions of the General Counsel going back to 1986 and in the final RESPA rule published on November 2, 1992 (57 FR 49600, and restated on February 10, 1994 (59 FR 6506)), that compensation received by a mortgage broker in a table-funded transaction is subject to disclosure. This interpretation treats mortgage brokers in table-funded transactions as *settlement service providers* ancillary to the loan, akin to title agents, attorneys, appraisers, etc., whose fees are subject to disclosure. This interpretation does not view a mortgage broker as the functional equivalent of a mortgage lender. Unlike a mortgage lender, the mortgage broker in a table-funded transaction does not

close the loan with its own funds. Conversely, a mortgage broker using its own funds, or with a ''warehouse'' line of credit for which it is liable, is not viewed as a mortgage broker, but rather as a mortgage lender under the extant HUD interpretation. The salient criterion for this conclusion is the source of funds. HUD's interpretation, embodied in the current RESPA regulations, has given rise to some controversy, as set forth in Section C of this preamble. In light of this controversy, the Department has elected to revisit and invite public comment on these issues. However, the Department wishes to stress to all concerned parties, and particularly to Federal and State regulators, that the Department's willingness to reexamine the issue does not affect the provisions of the current rule as now effective, unless and until modified. All affected parties should continue to make full disclosure of all direct and indirect compensation, as required by the current RESPA rule.

C. Criticism of Existing Policy

(1) HUD's Interpretation of the RESPA Statute is Incorrect. Opponents argue that the Department's interpretation of RESPA's disclosure requirements (''all charges imposed upon the borrower * * *'') to include indirect charges and payments from the borrower funds is too expansive and beyond the scope of the statute. They argue that all charges imposed on the borrower are fully included in direct charges. Indirect compensation need not be separately enumerated because it is already reflected in those direct charges. For example, the wholesale lender pays a retail lender fees from income received from the interest rate, points and other direct fees. Separate enumeration constitutes a redundancy, and combining direct and indirect costs overstates the total cost of the loan. Moreover, since the borrower is aware of the borrower's cost for the mortgage loan, no useful purpose is served by disclosing indirect charges reflected in points, interest rate, etc.

Second, opponents argue that a table-funded loan should be treated as a secondary market transaction. They maintain that such a transaction is the functional equivalent of a loan made by another type of lender, *e.g.*, a mortgage banker, who has an advance commitment to sell the loan shortly after settlement.

(2) HUD's Interpretation of the Statute Treats One Class of Participants Unfairly. First, mortgage brokers argue that an unlevel playing field is created, because mortgage bankers need not disclose the terms of a subsequent sale of the loan (although they do disclose origination fees and points, as well as other direct costs); mortgage brokers must effectively do so for table-funded transactions.

Second, by concluding that mortgage brokers engaged in table-funded transactions are not subject to the secondary market exemption, the Department has put an additional burden of scrutiny on these mortgage broker fees by making them subject to requirements of Section 8 of RESPA, which requires that all compensation be reasonably related to goods or services provided. The same scrutiny does not apply to the sales transactions of other originators that sell their loans to wholesale lenders following settlement.

(3) HUD's Interpretation of the RESPA Statute is Poor Public Policy. Opponents argue that retail lenders (particularly mortgage brokers) play an important role in making financing more available to ''nontraditional'' borrowers. They argue that HUD's interpretation, insofar as it places retail lenders at a competitive disadvantage, is not consistent with public policy designed to expand access to mortgage credit for such nontraditional borrowers.

Opponents also suggest that HUD's policy often requires retail lenders to spend added time and resources explaining the nature of indirect fees to a consumer. Occasionally, a consumer, or even an employee of a retail lender, will attempt to negotiate for a share of the fees paid to the retail lender.

D. Other Considerations and Concerns

(1) The fundamental premise underlying RESPA is that disclosure of information empowers the consumer to shop for better services and lower costs. All fees and charges, other than seller contributions, are ultimately borne by the borrower, whether by direct payments, such as points, or by indirect payments through a higher interest rate that the borrower pays over time. However, the seller also has a fundamental interest in this process, because the seller, particularly in difficult markets, is asked to absorb an increasingly greater part of the settlement costs. Knowledge of all fees, including those paid to a retail lender, may allow consumers to negotiate reductions in overall costs of the transaction.

(2) The Housing and Community Development Act of 1992 (Pub. L. 102–550; 106 Stat. 3672, at 3874) extended RESPA to junior lien transactions and confirmed the Department's position that refinancing transactions were covered by RESPA. As of August 9, 1994, the same principles of disclosure of indirect fees paid to mortgage brokers were extended to junior lien transactions. Refinancing and junior lien transactions are frequently advertised on a ''no point'' or ''no cost'' basis, which effectively means that all or much of the ancillary costs and charges of making the loan are contained in the interest rate or in a combination of the interest rate and the points. The consumer typically has a somewhat lesser interest in points and mortgage broker fees, in part because, unlike a purchase money transaction, points may only be amortized and deducted for Federal and State tax purposes over the life of the loan.

The high level of competitiveness through advertising and other publicity in the first mortgage industry, aided by the borrowers' interest in being able to make full IRS deductions, have helped assure that many of the costs of making a mortgage loan have been highly visible. However, while the Department has had extensive experience with purchase money and other first mortgage 1- to 4-family residential loans, because RESPA has only covered junior lien transactions since August 9, 1994, the Department has no comparable range of experience respecting junior lien transactions, which frequently are regulated and limited under different Federal or State laws and are funded by different institutions or branches of institutions. Therefore, the Department welcomes policy or legal commentary regarding the possibility of having one provision for first mortgage transactions and a second provision for junior lien transactions, or whether the Department should treat junior lien transactions made by retail lenders in the same manner as first lien purchase money and refinancing transactions.

(3) Under the statutory or judicial interpretations of the laws of several States, mortgage brokers are treated as agents of the consumer and are considered to have a fiduciary duty to disclose all fees that the mortgage broker obtains from the transaction. In Virginia, a case brought by the Virginia Poverty Law Center was settled when the major mortgage company agreed to restitution of certain fees collected by mortgage brokers, but without answering the fiduciary question. In California, where the courts have adopted the agency theory, the Department of Real Estate has implemented this requirement by creating a combined good faith estimate and mortgage broker disclosure form, thereby requiring all mortgage brokers (who close as many as 50 to 60 percent of all loans in the State) to disclose all direct, indirect, or anticipated mortgage

broker compensation. Because RESPA defers to State laws that provide more benefits to the consumer, any new interpretation by the Department will arguably not affect State provisions that provide for such direct and indirect mortgage broker fee disclosures. Also, while the Department has been informed that several class action law suits have been filed regarding the issue of payment of ''overages'' to mortgage brokers, the Department is not a party to these suits and is unaware of any effect an interpretation by the Department might have on the actions.

E. Possible Results of This Rulemaking

As a result of this rulemaking, HUD could establish uniform disclosure requirements for all retail lenders, either: (1) to require the disclosure of all direct fees paid to retail lenders by borrowers *and* to require disclosure of all indirect fees paid to retail lenders by wholesale lenders; or (2) to require the disclosure of all direct fees paid to retail lenders by borrowers only. In addition to, or instead of, modifying the rules on disclosure of fees in loan transactions, as a result of this rulemaking HUD may redefine what constitutes a ''secondary market transaction''. As set forth above, such transactions are exempt from RESPA, including, *inter alia*, its disclosure requirements, its prohibitions against kickbacks and referral fees, and its requirement that all compensation be reasonably related to the goods or services provided. HUD could define a ''secondary market transaction'' as a loan transaction involving: (1) the sale of a loan by a retail lender to a wholesale lender occurring after settlement (the position in the current regulations); (2) the sale of a loan by a retail lender at any time—before, contemporaneous with, or after settlement; or (3) the sale of a loan on some other date, such as after the first accrual date for the loan following settlement; *i.e.*, the date the first payment is due from the borrower under the loan.

Combining the two options of requiring either disclosure of direct and indirect fees, or disclosure of direct fees only, with the three possibilities for defining the secondary market transaction results in six alternative approaches to regulating settlement transactions under RESPA. Each of these six alternatives would have a different effect on each of the major types of loan transactions described above, including: (1) Loan closing and subsequent assignment of the loan; (2) loan closing in the wholesale lender's name using the wholesale lender's funds; and (3) table-funding. None of these alternatives will affect a fourth type of transaction—a portfolio transaction in which a retail lender processes, funds, and closes a loan in its own name for its own portfolio and the lender then holds the loan (if the loan is sold at all, the sale occurs long after settlement). Each of these alternatives or combinations of requirements is discussed below, along with its effect on each type of loan transaction. The public is specifically invited to comment on these six alternatives, as well as other approaches.

Alternative 1: The regulations would require the disclosure of direct and indirect fees at settlement, and a loan sale is classified as a ''secondary market transaction'' only if it occurs after settlement. This is the approach in the current RESPA rule. Under this alternative, the direct fees for a portfolio lender at settlement must be disclosed and the settlement transaction is subject to RESPA, there are no indirect fees, and any subsequent loan sale by the lender when indirect fees are paid is a secondary market transaction not subject to RESPA. Likewise, the direct fees for a retail lender at settlement, in other transactions involving a loan closing and subsequent assignment of the loan, must be disclosed, but any loan sale after settlement is a secondary market transaction not subject to RESPA (any indirect fees need not be disclosed and RESPA's other restrictions do not apply). In a table-funded transaction, the advance of loan funds to the borrower and the sale of the loan by the retail lender to a wholesale lender are contemporaneous with settlement. Accordingly, all direct and indirect fees to the retail lender must be disclosed under RESPA and the entire transaction—the making of the loan to the borrower and the loan sale—are subject to RESPA. Similarly, in a settlement transaction in the name of a wholesale lender—where there is no sale following settlement—all direct and indirect fees to and from the retail lender and the wholesale lender must be disclosed, and the entire transaction is otherwise subject to RESPA.

Alternative 2: The regulations would require the disclosure of direct and indirect fees at settlement, and any loan sale—before, contemporaneous with, or after settlement—is classified as a ''secondary market transaction''. Under this alternative, although disclosure of direct and indirect fees would be required for RESPA-covered transactions, more loan sales would be treated as ''secondary market transactions'' exempt from RESPA's coverage. As in Alternative 1, the direct fees to a portfolio lender at settlement must be disclosed, but any subsequent loan sale would be a secondary market transaction exempt from RESPA's disclosure and other requirements. Also, as in Alternative 1, the direct fees for other transactions involving a loan closing and subsequent assignment of the loan would have to be disclosed, but a subsequent loan sale would be a secondary market transaction exempt from RESPA. Unlike Alternative 1, the sale at settlement of a table-funded loan would also become a secondary market transaction exempt from RESPA's requirements and prohibitions. Indirect fees would not have to be reported and would not be covered by RESPA. Under a settlement transaction in the name of a wholesale lender, however, all direct and indirect fees to and from the retail lender and the wholesale lender would require disclosure, because there is no loan sale or secondary market transaction involved.

Alternative 3: Regulations require the disclosure of direct and indirect fees at settlement, and only loan sales following the first accrual—the date the first payment is due from the borrower under the loan—are ''secondary market transactions''. Under this alternative, RESPA's disclosure and other requirements would cover more transactions; only loan sales transactions that occur relatively long after settlement would be regarded as secondary market transactions exempt from RESPA's requirements. Under this alternative, loan sales by a portfolio lender—coming, if at all, well after the first loan payment—would be regarded as secondary market transactions. RESPA's disclosure requirements and restrictions would apply to a loan closing and subsequent assignment of the loan, unless the loan is sold after the first accrual date (currently, in most transactions the loans are sold much earlier). RESPA's prohibitions would apply to table-funded transactions when the loan is sold at settlement and transactions when a loan is closed in the name of a wholesale lender and there is no subsequent loan sale.

Alternative 4: Regulations require the disclosure of only direct (not indirect) fees at settlement, and a loan sale is classified as a ''secondary market transaction'' only if it occurs after settlement. This alternative differs from the current rule in requiring the disclosure only of direct fees from borrowers to retail lenders. Under this alternative, because there is no requirement for the disclosure of any indirect fees to retail lenders for loan sales, the classification of such sales as secondary market transactions is only determinative of whether RESPA's

requirements and prohibitions (other than disclosure) apply to the transaction. Under this alternative, direct fees to retail lenders must be disclosed in portfolio transactions, other transactions involving a loan closing and subsequent assignment of the loan, table-funding transactions, and transactions in which a retail lender closes in the name of a wholesale lender (including any direct fees to the wholesale lender). Because retail lenders in portfolio transactions and other transactions involving a loan closing and subsequent assignment of the loan sell their loans after settlement, such sales would be subject to the secondary market exemption and outside of RESPA. Because loan sales in table-funded transactions occur at and not after settlement, under this alternative, such sales transactions would not be secondary market transactions and would be subject to RESPA (although indirect fees need not be disclosed). Also, because a loan in the name of a wholesale lender occurs at settlement and there is no subsequent sale, the retail and wholesale lender's transaction would be subject to RESPA's prohibitions.

Alternative 5: Regulations require the disclosure of only direct (not indirect) fees at settlement, and a loan sale, at any time, is classified as a ''secondary market transaction''. Under this alternative, direct fees to retail lenders must be disclosed in portfolio transactions, other transactions involving a loan closing and subsequent assignment of the loan, and table-funding transactions, as well as transactions in which retail lenders close in the name of a wholesale lender. Any loan sales (following settlement) by portfolio lenders, or under another transaction involving a loan closing and subsequent assignment of the loan, would be secondary market transactions outside of RESPA's coverage. Under this alternative, a loan sale (at settlement) in a table-funded transaction would also be a secondary market transaction. However, settlement in the name of the wholesale lender not involving a sale, would not be subject to the exemption—RESPA would apply to the entire transaction although indirect fees need not be disclosed.

Alternative 6: Regulations require the disclosure of only direct (not indirect) fees at settlement, and a loan sale is classified as a ''secondary market transaction'' only if it occurs after the first accrual date. Under this alternative, direct fees to a retail lender must be disclosed in a portfolio transaction; a transaction involving a loan closing and subsequent assignment of the loan; a table-funding transaction; and a transaction in which a lender closes in the name of another lender. Although indirect fees need not be disclosed, RESPA's other requirements would cover more transactions, because fewer transactions would be regarded as secondary market transactions. The exception is a loan sale by a portfolio lender, which, when it occurs, would follow the first accrual date and would, therefore, still be regarded as a secondary market transaction. Loan sales transactions by retail lenders in other transactions involving a loan closing and subsequent assignment of the loan and in table-funded transactions would not be regarded as secondary market transactions and would be subject to RESPA. Settlement in the name of the wholesale lender, because it does not involve a sale, would not be subject to the exemption and RESPA's provisions would also apply to the entire transaction.

HUD seeks comments from the public on which, if any, of these alternative approaches should result from this rulemaking, or whether other approaches that would be permissible under RESPA would better serve the interests of the public and the intent of the statute.

II. Volume-Based Compensation

Volume-based compensation is a payment of money or any other thing of value, as defined by 24 CFR 3500.14(d), that a wholesale lender provides to a retail lender and is based on a number or dollar value of loans that the retail lender sells to the wholesale lender in a fixed period of time.

Volume compensation also encompasses volume discounts, in which a retail lender that is to provide a stated volume of loans is given a lower ''start-rate'' than the wholesale lender's advertised rate and the retail lender keeps a differential between the start rate and the advertised rate as part of its compensation at settlement.

The Department believes that volume-based compensation is a fairly widespread practice, particularly in California. As noted above, California regulatory requirements provide for disclosure to borrowers of this compensation (the amount, if known, or its potential for receipt by the mortgage broker). HUD has never enunciated a formal policy on whether volume-based compensation is permissible under RESPA. If the Department concludes that it is allowable, the issue also arises as to whether and how the payment should be disclosed on the Good Faith Estimate and the HUD–1 and HUD–1A.

A. Should Volume-Based Compensation be Permitted?

Critics argue that volume-based compensation may lead to loan-steering. Arguably the consumer's interest (in seeing a range of loan options) may be subordinated to the interest of the retail lender in receiving greater compensation from a particular wholesale lender.[2] Also, as discussed earlier in this preamble, Section 8 of RESPA prohibits payments in the absence of ''goods or facilities furnished or for services actually performed.'' Therefore, awarding additional compensation for loans closed above a threshold number, where no added services are provided, could, standing alone, violate RESPA.

On the other hand, others argue that volume-based compensation may be an appropriate payment for goods or services actually performed. Wholesale lenders must exercise careful oversight over retail lenders, because decisions by the retail lender can expose the wholesale lender to default risk. For this reason, wholesale lenders typically perform some underwriting review for each mortgage. There also must be a good working relationship between the staffs of the retail and wholesale lender to ensure that important matters, such as document transfer and the handling of escrow funds, are accomplished smoothly and punctually. Establishing this working relationship and oversight involves some fixed costs to the wholesaler, which decrease on a per loan basis as the volume of business increases. The wholesale lender's variable costs may also decrease with increased volume, because the retail lender becomes more familiar with the requirements of the wholesale lender and the wholesale lender's staff is more familiar with the product and practices of the retail lender. Declining per-unit costs may justify volume compensation.

The consumer may benefit from volume-based compensation. In competitive markets, price concessions from wholesale lenders to high-volume retail lenders generally get passed along to the consumers. To obtain the volume of business needed to obtain price concessions and to benefit from volume-based compensation, the retail lender may pass along part of the high-volume benefits to the consumer, through lower points or other cost savings.

Critics argue that if the retail lender originates in its own name, the consumer is generally unaware that the

[2] Retail lenders who fail to present a full range of loan options to all consumers may risk charges of discriminatory treatment on a prohibited basis, which is unlawful under the Fair Housing Act.

retail lender has wholesale options available and may not even be consciously aware of the retail lender's intention to sell the mortgage. In this context, steering does not exist in the typical sense, that is, advising the consumer to choose lender A over lender B when lender B's prices are as good as, or better than, lender A's prices. It is also conceivable that wholesale lender X may not offer a loan product that wholesale lender Y offers, such as a 15-year adjustable rate mortgage (ARM). The retail lender may influence the consumer not to select the 15-year ARM so that the retail lender can increase its business with lender X, which offers volume compensation. However, most wholesale lenders offer a comparable range of products.

In addressing the policy issues of whether and how volume-based compensation should be permitted and, if so, disclosed, a commenter may offer legal arguments as to whether RESPA prohibits the practice.

B. Is Volume-Based Compensation Subject to Disclosure?

A retail lender required to make disclosure could argue that HUD has created an ''uneven playing field'' between mortgage bankers and other retail lenders, inasmuch as the issue of volume-based compensation is not relevant for mortgage banker transactions. (See Section II.C.(2) of this preamble.)

If HUD decides to allow this kind of compensation, practical questions are raised about how to disclose this information—what numbers should be disclosed? At the time of a given closing, a retail lender may not know whether a volume-based payment will be received or how much it will be. As noted above, the California standard Good Faith Estimate and Mortgage Broker Fee Disclosure form requires the disclosure of the compensation, if known, or an indication that a mortgage broker will receive additional compensation.

III. Other Compensation

In addition to volume-based compensation, retail lenders also receive compensation from wholesale lenders under a variety of names, the most common of which are ''servicing release premiums'' and ''yield spread premiums'' (which are cited by name in the current RESPA regulation as compensation to be disclosed; 24 CFR part 3500, Appendix A, Fact Situation 12.) Such compensation is also included in ''rate differentials,'' ''indirect payments,'' or ''back-funded payments'' (occasionally called ''back-end points'') in Appendix A instructions for filling out the HUD–1A. A ''yield spread premium'' or ''yield spread differential'' or ''overage'' means any compensation paid to or retained by a retail lender based upon the difference in the interest rate provided in the sold loan and some other benchmark interest rate. It compensates the retail lender for a loan priced at a rate higher than the rate at which the wholesale lender would otherwise have been willing to accept the loan. A ''servicing release premium'' is any compensation paid to a retail lender for the release of rights to service the loan.

The names of the fees (those cited in the previous paragraph may vary) are not definitive or dispositive. The concerns of the Department regarding such forms of compensation are similar to those expressed regarding volume-based compensation; that is, do those fees constitute kickbacks or fee-splitting for delivery of the loans. Commenters are invited to address: (a) whether any such types of compensation should be permissible under RESPA; and (b) what would be the effect of requiring disclosure of such payments.

IV. Proposed Amendments to 24 CFR Part 3500

In this proposed rulemaking HUD is requesting comment on several questions that may lead to new regulatory language in 24 CFR part 3500. For example, several new definitions are proposed for inclusion in § 3500.2. In addition, § 3500.14(g) would be revised to address explicitly the applicability of RESPA to volume-based compensation, and Appendix B, Fact Situation 12, could be modified. HUD may also need to modify the HUD–1 and HUD–1A instructions regarding payments to mortgage brokers. If new definitions are adopted, other definitions may need to be modified for consistency. While the Department has set forth illustrative changes in the definitions, it has not attempted to provide alternative regulatory text for every possible amendment that might result from this rulemaking. Instead commenters are invited to comment on the questions raised in this preamble and provide input on the direction they believe the Department should take on these matters.

If a determination is made that regulatory changes should be developed through a negotiated rulemaking process, the Department expects to publish another proposed rule at the conclusion of the negotiation process and will provide the negotiating committee with the comments submitted in response to today's proposed rule. If negotiated rulemaking is not used, the Department will formulate its final rule after reviewing the comments received in response to this proposed rule.

V. Other Relevant Issues

(a) Recent Legislation. In 1994 Congress enacted the Riegle Community Development and Regulatory Improvement Act of 1994 (Pub. L. 103–325, 108 Stat. 2160, September 23, 1994) (the Act), which includes, as Subtitle B, the Homeownership and Equity Protection Act of 1994. Subtitle B requires the Federal Reserve Board to require additional levels of disclosure in certain circumstances, and requires for its computations inclusion of all compensation paid to mortgage brokers, including both direct and indirect payments, in order to determine if the loan will be a ''high-rate mortgage.'' (See section 152(a)(4)(B) of the Act.) If HUD ultimately determines that indirect fees need not be disclosed in a final rule, the Federal Reserve Board (which relies on information contained in HUD's Good Faith Estimate and the HUD–1 or HUD–1A forms) might have to require its own cost disclosure form in order to determine coverage. Accordingly, HUD plans to invite staff of the Board to comment on the proposed rule. The public is also welcome to address this matter.

(b) Impact of Regulation on State Laws. Whatever HUD determines in final rulemaking, it is possible that a State may have more stringent disclosure requirements than HUD. Under RESPA, State laws that provide greater protection to the consumer would prevail and would not be preempted by HUD requirements. Of course, a salient issue embraced within this proposed rulemaking is whether more disclosure is, in fact, beneficial to consumers. In addressing the alternative proposals in this rulemaking, a basic question for commenters is whether disclosure of the terms of a mortgage loan (e.g., interest rates and points) alone is sufficient consumer information.

VI. Other Matters

Executive Order 12866

This proposed rule was reviewed by the Office of Management and Budget under Executive Order 12866, Regulatory Planning and Review. Any changes made to the proposed rule as a result of that review are clearly identified in the docket file, which is available for public inspection in the Office of the Rules Docket Clerk, Room

10276, 451 Seventh Street, SW, Washington, DC.

Regulatory Flexibility Act

The Secretary, in accordance with the Regulatory Flexibility Act (5 U.S.C. 605(b)), has reviewed this proposed rule before publication and by approving it certifies that this proposed rule does not have significant economic impact on a substantial number of small entities. There are no anticompetitive discriminatory aspects of this proposed rule with regard to small entities, nor are there any unusual procedures that would need to be complied with by small entities. The requirements of the Real Estate Settlement Procedures Act must be uniformly adhered to by all lenders and servicers.

Environmental Impact

A Finding of No Significant Impact with respect to the environment has been made in accordance with HUD regulations in 24 CFR part 50 that implement section 102(2)(C) of the National Environmental Policy Act of 1969 (U.S.C. 4332). The finding is available for public inspection during regular business hours in the Office of the General Counsel, Rules Docket Clerk, room 10276, 451 Seventh Street, SW., Washington, DC 20410.

Executive Order 12612, Federalism

The General Counsel, as the Designated Official under section 6(a) of Executive Order 12612, Federalism, has determined that the policies contained in this proposed rule will not have substantial direct effects on States or their political subdivisions, or the relationship between the Federal government and the States, or on the distribution of power and responsibilities among the various levels of government. As a result, the proposed rule is not subject to review under the Order. Promulgation of this rule clarifies the coverage of the applicable regulatory requirements.

Executive Order 12606, The Family

The General Counsel, as the Designated Official under Executive Order 12606, The Family, has determined that this proposed rule does not have potential for significant impact on family formation, maintenance, and general well-being, and, thus, is not subject to review under the order. No significant change in existing HUD policies or programs will result from promulgation of this rule, as those policies and programs relate to family concerns.

List of Subjects in 24 CFR Part 3500

Consumer protection, Condominiums, Housing, Mortgages, Mortgage servicing, Reporting and recordkeeping requirements.

For the reasons stated in the preamble, 24 CFR part 3500 is proposed to be amended to address the regulatory questions raised in the preamble and as follows:

PART 3500—REAL ESTATE SETTLEMENT PROCEDURES ACT

1. The authority citation for Part 3500 continues to read as follows:

Authority: 12 U.S.C. 2601 *et seq.*

2. Section 3500.2 is amended by adding in alphabetical order definitions for ''Direct fee'', ''Indirect fee'', ''Retail lender'', ''Secondary market transaction'', ''Volume-based compensation'', and ''Wholesale lender'', to read as follows:

§ 3500.2 Definitions.

* * * * *

Direct fee means any payment made by a borrower to a lender or any other settlement service provider or to a third party, to be transmitted to a lender or any other settlement service provider, in connection with a settlement of a federally related mortgage loan.

* * * * *

Indirect fee means any payment made by a wholesale lender to a retail lender for services rendered in connection with a federally related mortgage loan origination. [Indirect loan fees are not subject to disclosure on the Good Faith Estimate or the HUD–1 or HUD–1A.]

* * * * *

Retail lender means a person who originates and sells a federally related mortgage loan to a wholesale lender.

Secondary market transaction means a sale of a federally related mortgage loan. A secondary market transaction [as defined by one of the alternatives set out in the preamble of this proposed rule] [is/is not] covered by RESPA and this part, except as set forth in Section 6 of RESPA (12 U.S.C. 2605) and § 3500.21.

* * * * *

Volume-based loan compensation means any added payment or additional thing of value provided by a wholesale lender to a retail lender to a retail lender based on the number or dollar value of loans originated.

Wholesale lender means a person who purchases a mortgage loan from a retail lender.

Dated: August 11, 1995.

Jeanne K. Engel,

General Deputy Assistant Secretary for Housing—Federal Housing Commissioner

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